IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

PHOENIX TITLE &
TRUST COMPANY,

Appellant,

vs.

MYLES STEWART, Trustee of the
Estate of ARTHUR PEABODY and
OLIVE PEABODY,

Appellees.

No. 18819

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
DISTRICT OF ARIZONA

REPLY BRIEF FOR APPELLEE STEWART

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JURISDICTIONAL STATEMENT

This is an appeal from an Order entered on March 29, 1963, by the United States District Court for the District of Arizona affirming the Order of the Referee in Bankruptcy entered May 31, 1962.

This appeal is brought under the jurisdiction established in Section 24 of the Bankruptcy Act, 11 USCA Paragraph 47.

INTRODUCTION

For the sake of clarity, the Phoenix Title & Trust Company, Inc., in its capacity as a creditor of the bankrupt estate will hereinafter be referred to as the "creditor"; the Phoenix Title & Trust Company, Inc., in its capacity as Trustee under the terms of the conveyance by the bankrupts will hereinafter be referred to as the "Trust Company"; all events transpired in Tucson, Pima County, Arizona.

The Transcript of Record will be designated "T.R.", and the Reporter's Transcript will be designated "R.T.".

STATEMENT OF THE CASE

This case grows out of an Involuntary Bankruptcy in which the Bankrupts Peabody had executed four documents:

1. A Deed to Phoenix Title & Trust Company, as Trustee;
2. A Trust Agreement with the Peabodys as beneficiaries and Phoenix Title & Trust Company as Trustee;
3. A Note from the Peabodys to Phoenix Title & Trust Company, creditor, and
4. A Collateral Assignment of the Peabodys' beneficial interest in the Trust Agreement to Phoenix Title & Trust Company, a creditor.

The corpus of the Trust consisted of certain real property and the rights that go with this property. Loss of part of the property and those rights at the time of Bankruptcy had resulted in a cash condemnation award. Said award was not paid until after the adjudication of the Peabodys as Bankrupts.

The Trustee in Bankruptcy and the creditor are disputing the claim made by the creditor that the instruments between the parties are, in effect, a mortgage, and that the recording of the Deed placed the creditor's rights prior in time and security to the Trustee.

It is the Trustee's contention that the Peabodys dealt with Phoenix Title & Trust Company in two capacities, and that the Trustee is prior in time and in security to Phoenix Title & Trust Company, and is therefore entitled to all of the real property and the rights that go with that property as an asset of this Bankrupt Estate. The Referee in Bankruptcy and the District Judge both ruled in favor of the Trustee in Bankruptcy.

FACTS OF THIS CASE

It is pointed out at this early stage of this brief that the "facts" as presented by the creditor-Appellant confuse the issue completely as to the status of "Phoenix Title & Trust Company." All discussions and arguments must of necessity distinguish between Phoenix Title & Trust Company, as Trustee, and Phoenix Title & Trust Company, as creditor. The entire brief of the creditor-Appellant, by attempting to cast Phoenix Title & Trust Company as one entity, rather than a corporation acting in two capacities, is done merely to add weight to the position of Phoenix Title & Trust Company, as creditor, and is a misstatement of fact and law.

An involuntary Bankruptcy Petition was filed against the bankrupt Peabodys on the 15th day of April, 1959. The Peabodys were duly adjudicated bankrupt. The involuntary petition was filed by Ashby Lohse as attorney for William T. Fitchett, Edwin W. Smalley, and Paul E. Greer.

Prior to the filing and adjudication in the involun-

tary proceeding, the Bankrupts and the Trust Company, the Appellant, entered into a transaction described as follows:

> By a recorded Deed, Exhibit 1, Recorder's Transcript, page 136, title to a parcel of real property in Pima County, Arizona, was transferred to the Trust Company, as Trustee. By a separate unrecorded Trust Agreement, Exhibit 1B, the title was held in trust for the Peabodys. The Trustee's Deed was dated July 23, 1956, and acknowledged by the Peabodys on July 26, 1956, was recorded at the request of the Trust Company on July 31, 1956, and duly appears in the records of the County Recorder, Pima County, Arizona. The beneficiaries of the trust are not named in the Trustee's Deed. The Trust Agreement, Exhibit 1B, dated July 23, 1956, was acknowledged by the Peabodys on July 26, 1956, and by officers of the Trust Company on July 31, 1956. Both the Trustee's Deed and the Trust Agreement bear the identification number, "Trust No. 6007."

The Trust Agreement provides that the property to which the Trust Company received title as Trustee (the real property described in the Trustee's Deed, Exhibit 1, which will hereinafter be referred to as the real property), was to be held in trust by the Trustee, the Trust Company, for the beneficiaries, Arthur Peabody and Olive C. Peabody, for the purposes of,

> "subdividing, platting, deeding, selling, conveying, receiving payment for and otherwise handling the property as a whole or in lots and parcels, upon such terms and conditions and for such prices as the Trustee may be instructed in writing so to do by the beneficiaries or their authorized representatives."

Under the provisions of the Trust Agreement, Exhibit 1B, the Trust Company is granted no discretionary

powers and is charged with no responsibility in handling and managing the property. The prescribed duties of the Trust Company are ministerial in nature, to be performed under the direction of the beneficiaries. The settlors, Arthur Peabody and Olive C. Peabody, remained in possession and control of the property and were in possession and control of the property at the time of the bankruptcy herein, with all powers of management, charged with full responsibility for handling the property in carrying out the stated purposes of the trust.

The Trustee's Deed and the Trust Agreement contain no provision that the instruments were executed as security for the performance on the part of the Peabodys of any contract between them and the creditor. There is no reference in the Trustee's Deed or in the Trust Agreement to any other instrument executed or to be executed by the Peabodys as security for the performance on the part of the Peabodys of any contract between them and the creditor.

The Deed to the Trust Company as Trustee and the Trust Agreement were executed by the parties with the intention of establishing a passive depository of the legal title to the real property, with the actual and equitable ownership remaining in the Peabodys for their own use and benefit. The Trust Company as Trustee did not take title to the property as security for the performance of any contract or obligation to be performed on the part of the Peabodys.

On July 24, 1956, the Peabodys made their promissory note, Exhibit 1D, in the principal amount of $50,000.00, payable to the "creditor" on or before July 24, 1957, with interest at the rate of six (6%) per cent per annum from July 24, 1956, interest payable at

maturity. The note recites that it is secured by a collateral assignment, Exhibit 1C, of Peabodys' beneficial interest in Trust No. 6007.

That the "creditor" drew checks payable as follows:

1. Check No. 108, in the amount of $32,701.45, to Arthur Peabody and Olive C. Peabody; for "proceeds of your loan from Phoenix Title & Trust Co."

2. Check No. 107, in the amount of $375.00, to Associated Engineering Co.; for "balance due for cross-sectioning streets in Littletown."

3. Check No. 106, in the amount of $16,712.31, to Valley National Bank; for "payment in full of mortgages from Ackley, DeBand, Kemmeries."

With their note given to the "creditor" on July 24, 1956, the Peabodys, as assignors, executed an instrument designated as "Collateral Assignment of Beneficial Interest" (hereinafter referred to as the assignment) wherein the "creditor" is named as assignee. The assignment bears undated endorsements signed by officers of the "creditor," whereby the "creditor" approves and accepts the assignment as assignee and accepts the assignment as Trustee. The assignment was acknowledged by the Peabodys on July 26, 1956, but was never recorded.

That the Exhibits 1 (deed), 1B (Trust Agreement), 1C (Collateral Assignment), and 1D (note) do not constitute an assignment passing legal title to the "creditor," nor a present assignment of a beneficial interest in property. Furthermore, Exhibit 1 is not a mortgage.

The Collateral Assignment refers to the promissory note for $50,000.00, given by the Peabodys to the "creditor" on July 24, 1956, and provides that for the purpose of securing payment of said note, the assignor does thereby assign, convey, transfer and set over unto the assignee all of his rights, powers, privileges, proceeds and avails of the beneficiary created or reserved, and all of the interest of the beneficiary in Trust No. 6007, insofar as the real property is concerned. The "assignment" contains release clauses in relation to said property, reading as follows:

> "It is provided that the lots into which the property is subdivided may be released by assignor upon the payment to trustee for the benefit of assignee of the sum of $600.00 per lot, said amount to be applied first to the payment of interest to the first of the month next succeeding the date when such funds are available for distribution to assignee and the balance to be applied on (the) principal.
>
> "It is further provided that in the event that the assignor herein has set up a sales escrow in the Phoenix Title and Trust Company that trustee will be authorized to convey a lot or lots to said assignor without the payment of any consideration provided assignor is obtaining a construction loan (including any refinancing, renewal, or increase thereof) from a bona fide lending agency and provided said escrow provides that out of the sales price of said home the escrow agent shall remit the release price and all expenses of sale and conveyance by trustee for such lot or lots to the trustee, it being understood that this amount must be paid not later than the date on or before which the note secured hereby is to be paid in full. The release price herein referred to is the amount of $600.00 per lot as herein set forth."

The "assignment" also provides in the event of

default on the part of the Peabodys in the payment of their note or any of the terms of the assignment that

> "the whole amount of the principal sum and any amount advanced by the assignee . . . shall be . . . deemed to have become due and the same . . . shall be collectible in a suit at law or by foreclosure . . . *as if this collateral assignment of Beneficial Interest were a mortgage. . . .*"
> (Emphasis supplied)

The assignment further provides for the appointment of a receiver "to take charge of said Beneficial Interest and said property."

A notice of tax lien against the Peabodys in favor of the United States of America, dated August 27, 1957, for $4,268.21, was filed August 28, 1957, fee No. 52633, in the office of the County Recorder of Pima County, Arizona.

A notice of tax lien against the Peabodys in favor of the United States of America, dated September 19, 1957, for $2,076.67, was filed September 21, 1957, fee No. 57827, in the office of the County Recorder of Pima County, Arizona.

The only documents recorded or filed in the office of the Pima County Recorder, or elsewhere in Arizona, as evidence of the agreement between the bankrupt and Phoenix Title & Trust Company, as Trustee, or Phoenix Title & Trust Company, the "creditor," was the Deed mentioned as Exhibit 1.

On December 12, 1958, the "creditor" brought an action against the Peabodys and others alleging, in substance, that the Peabodys had given the "creditor" their note for $50,000.00 on July 24, 1956, and in anticipation thereof, and as part of the same transaction, in order to secure the payment of said note, the

parties made and executed the Trust Agreement wherein the Peabodys were beneficiaries and the Trust Company was Trustee under Trust No. 6007; that with the delivery of said note as part of the same transaction, in order to secure the payment of said note, the Peabodys executed and delivered to the "creditor" the assignment of all their beneficial interest in and to all the assets held by the Trust Company under Trust No. 6007; that the Peabodys had defaulted upon the note and assignment under the Trust securing said note; that the sum of $42,536.24, with interest from October 1, 1957, was then due. The complaint demanded, among other things, the following relief:

> "For judgment against Arthur Peabody and Olive C. Peabody, husband and wife, and Paul E. Greer and Evelyn C. Greer, in the sum of $42,536.24 together with interest as provided in said note from October 1, 1957, until paid for plaintiff's attorney fees in a sum equal to ten (10) per cent of all sums found due to date of judgment.
>
> "That the respective *collateral assignments* of defendant Arthur Peabody's and Olive C. Peabody's beneficial interest in the assets of the trust hereinabove referred to be declared to be a first and prior lien against their interest in the property involved, and that said assignments be foreclosed as a mortgage, and the premises therein described and all of said defendants' interest under the terms of said trusts be sold under execution according to the law and practice of this Court to satisfy the demand of the plaintiff. That out of the proceeds of said sale, the plaintiff be paid the amount due; that in case of a deficiency arising from said sale, the plaintiff have judgment for the amount thereof; and that at said sale the plaintiff or any other person to this cause may become purchasers of said premises; that all defendants and all persons or corporations claiming to, under or from

them and all persons having a lien subsequent to said Assignments be forever barred and foreclosed of and from all equity of redemption and claim of, in or to said assigned premises and every part and parcel thereof from and after the delivery of the Sheriff's Deed." (Emphasis supplied)

The action, designated in the docket of said Superior Court as No. 57402, had not been prosecuted to judgment at the time of bankruptcy herein and the case is still pending.

Certain Findings of Fact and Conclusions of Law by the Referee are set forth as they show the Court's Findings of Facts and are repeated here for clarification and amplification.

Finding of Fact II states, in part:

"Under the provisions of the trust agreement the trustee is granted no discretionary powers and is charged with no responsibility in handling and managing the property. The prescribed duties of the trustee are ministerial in nature, to be performed under the direction of the beneficiaries. The trustors, *Arthur Peabody and Olive C. Peabody, remained in possession and control of the property and were in possession and control of the property at the time of the bankruptcy herein,* and with all powers of management, charged with full responsibility for handling the property in carrying out the stated purposes of the trust." (Emphasis supplied.)

Finding of Fact IV states:

"The deed to Phoenix Title as trustee and the trust agreement were executed by the parties with the intention of establishing a passive depository of the legal title to the real property, with the actual and equitable ownership remaining in the Peabodys for their own use and benefit. *Phoenix Title did not take title to the property as security for the performance of any contract or obligation to be performed*

on the part of the Peabodys." (Emphasis supplied.)

Conclusion of Law No. 7 states:

"At the time the notice of each of the federal tax liens was filed as provided in Section 6323 of the Internal Revenue Act of 1954, and at the time of bankruptcy herein, Phoenix Title had *no right in the corpus of Trust No. 6007* as a mortgagee, pledgee, purchaser or judgment creditor." (Emphasis supplied.)

Conclusion of Law No. 8 states:

"At the time the notice of each of the federal tax liens was filed as provided in Section 6323 of the Internal Revenue Act of 1954, and at the time of bankruptcy herein, Phoenix Title had no right in the beneficial interest of the Peabodys in Trust No. 6007 as a mortgagee, pledgee, purchaser or judgment creditor."

Conclusion of Law No. 16 states:

"The real and personal property, title to which is in the name of Phoenix Title by virtue of the deed and trust agreement establishing Trust No. 6007, were assets of the Peabodys at the time of bankruptcy herein and are now assets of the estate of said bankrupts and should be administered by the bankruptcy trustee in these proceedings."

STATUTES INVOLVED

Arizona Revised Statutes:

Section 1-215(22)
Section 33-412A
Section 33-702
Section 33-751(2)
Section 33-753(a)

Internal Revenue Code of 1939:

Section 3672(a)

Internal Revenue Code of 1954:

Section 6323

26 U.S. Code:

Section 6321
Section 6322 (formerly Section 3671)

United States Bankruptcy Act:

Section 70(c)
Section 70(e)

AUTHORITIES

1A Bogert, Trusts and Trustees, Section 206.
90 C.J.S., Trusts, Section 178.
Collier on Bankruptcy, Section 70.45 through Section 70.55.

QUESTIONS PRESENTED

1. Is the lien of Phoenix Title & Trust Company, creditor, voidable under Sec. 70(c) of the Bankruptcy Act?

   (a) Is the Trust Agreement between the Bankrupts Peabody and Phoenix Title & Trust Company an active or passive trust?

   (b) If passive, is it executed by the Statute of Uses?

   (c) If active, was there an equitable conversion which required Phoenix Title & Trust Company to file the instruments as a chattel mortgage?

   (d) Did the failure of Phoenix Title & Trust Company to file the trust deed render it void as to creditors and, therefore, the Trustee-Appellant?

2. Is the lien of Phoenix Title & Trust Company, creditor, inchoate and void as to the United States Government, and therefore as to the Trustee under Sec. 70(c) of the Bankruptcy Act and Sec. 6323 of the Internal Revenue Code of 1954?

ARGUMENT
AN INCHOATE LIEN

In *United States v. R. F. Ball Construction Company,* 78 S.Ct. 443, 355 U.S. 587 (1958), the Court said, "The instrument involved being inchoate and unperfected, the provisions of Sec. 3672(a) of the Revenue Act of 1939 do not apply." The "instrument" in question was an imperfect assignment. It follows in this case that the transaction between the Bankrupt Peabodys and Phoenix Title & Trust Company, as a creditor, if inchoate, results in the Federal tax lien under Revenue statute 6323 to be prior in time and in security to the lien of the creditor, and therefore, the Trustee is prior under Sec. 70(c) of the Bankruptcy Act.

It is the contention of the Trustee that the creditor's lien was inchoate and unperfected by any of the following tests:

(a) The identity of the lienors was not fixed (because the lien was secret for lack of recordation). *United States v. Knott,* 298 U.S. 544, 56 S.Ct. 902 (1936).

(b) Neither title nor possession was in the "creditor." *United States v. Gilbert Associates,* 345 U.S. 361 (1953); *United States v. Carroll Construction,* 346 U.S. 802 (1953), reversing 249 P.2d 234.

(c) The "identification" of the property subject to the lien was not specific and consistent, *United States v. Texas,* 314 U.S. 480 (1941), for the reason that parcels could be released and the lien was not recorded, if the "creditor's" claim is made on the collateral assignment for the reason it was not recorded. The Court is referred to: *United States v. Scovil,* 348 U.S. 218 (1955), reversing 78 S.E.2d 277; *United States v. Colotta,* 350 U.S. 808 (1955), reversing 79 So.2d 474; *United States v. White Bear Brewing Co.,* 350 U.S. 1010 (1956), reversing 227 F.2d 359; *United States v. Vorreiter,* 355 U.S. 15 (1957), reversing 307 P.2d 475.

These cases and the *Ball* case certainly render any lien the Title Company might have inchoate and not subject to the protection given to a ". . . mortgagee, pledgee, purchaser or judgment creditor . . ." in Par. 6323 of the Internal Revenue Code.

As the dissent says in the *Ball* case, at page 445, re Sec. 3672(a), that section does not define the term "mortgagee" and hence we must assume that it was there used in its ordinary and common law sense. Certainly in the case at bar, a Deed to a Trustee or a Collateral Assignment of a Beneficial Interest are not a mortgage in the "common law sense." See also *Beeghly v. Wilson,* 152 F. Supp. 726 (D.C. Iowa 1957).

Interests of "mortgagees" do not force a less demanding test of perfection than do other interests when competing with Federal liens. "We reject the contention that the choateness rule has no place when a 'mortgage' under Sec. 6323 (a) is involved." *United States v. Pioneer American Insurance Co.,* 357 S.W.2d 653 (Ark. 1962),

cert. granted 371 U.S. 909, 83 S.Ct. 254, 9 L.Ed. 2d 169 (1963).

By Federal statute, liens for taxes owing to the United States arise upon receipt by the collector of the assessment list (U.S. Code, Title 26 Par. 6322, formerly Par. 3671), but they attach only to "property and rights to property" belonging to the taxpayer (6321). To quote a succinct comment by Judge Medina:

> "In adopting this legislation, the Congress did not create property interests on which a lien might be imposed; there is no suggestion that it authorized the federal courts to do so. On the contrary, it took for granted here, as it normally does in the tax law, the vital existence of state laws creating and maintaining various interests. The statute was fashioned to require the courts to determine for federal purposes whether those state-created interests are 'property' or 'rights to property'. That classification of interests is a federal question; the existence of the interests to be federally classified, however, is solely a question of state law." *Fidelity & Deposit Co. of Maryland v. New York City Housing Authority,* 241 F.2d at page 144.

In the instant case it is the bankruptcy which transfers the property and rights to property of the bankrupt taxpayer to the Trustee in Bankruptcy.

There seems to be some question in the minds of the creditor-Appellant that the rights of the Trustee under Sec. 70(c) of the Bankruptcy Act were modified by *Constance v. Harvey,* 215 F.2d 571 (1954). There is no question that the Trustee's rights under Sec. 70(c) of the Bankruptcy Act now must be ascertained as of the date of Bankruptcy. The *Constance* case did modify *Lewis v. Manufacturers National Bank of Detroit,* 364 U.S. 603, 81 S.Ct. 347, 5 L.Ed. 2d 323 (1961). The "strong arm clause" of Sec. 70(c) of the Bankruptcy Act,

without using the doctrine of relating back to prior points in time, does not need to be used by the Trustee in this case as there never was a recording of the creditor's security instrument other than the Deed to the Trust Company as Trustee.

In the instant case the Referee in Bankruptcy based his conclusions on Sec. 70(e) of the Bankruptcy Act, which argument is supported by the cross-Appellant Myles Stewart, Trustee of the Bankrupt Estate, and the United States District Court Judge based his decision on Sec. 70(c) of the Bankruptcy Act. It is respectfully contended that both Sec. 70(c) and Sec. 70(e) of the Bankruptcy Act could be used as the basis of the decision, as well as the Arizona law.

The Court is referred to Sec. 70.45 through Sec. 70.55, Collier on Bankruptcy, for a complete discussion of Sec. 70(c) of the Bankruptcy Act.

The creditor, in his Appellant's Opening Brief, seems to make the argument that because a "Trust Deed" was used and recorded that some special rights attach. It is respectfully pointed out again that the State of Arizona does not have a Trust Deed statute, as does California. The Deed to Phoenix Title & Trust Company, as Trustee, was recorded in accordance with Arizona Revised Statute Sec. 33-412(a), which reads as follows:

> "Invalidity of unrecorded instruments as to bona fide purchaser or creditor.
>
> A. All bargains, sales, and other conveyances whatever of lands, tenements and hereditaments, whether made for passing an estate of freehold or inheritance or an estate for a term of years, and deeds of settlement upon marriage, whether of land, money or other personal property, and deeds of trust and mortgages of whatever kind shall be void as to creditors and subsequent

purchasers for valuable consideration without notice, unless they are acknowledged and recorded in the office of the county recorder as required by law, or where record is not required, deposited and filed with the recorder."

We admit the Deed was recorded. The fact of recording adds nothing of value to the argument that the Deed is a "Trust Deed."

Arizona Revised Statutes Sec. 33-702 reads as follows:

"Mortgage defined; pledge distinguished; admissibility of proof that transfer is a mortgage.

"Every transfer of an interest in property, other than in trust, made only as a security for the performance of another act, is a mortgage, except a transfer of personal property accompanied by an actual change of possession, which is deemed a pledge. The fact that a transfer was made subject to defeasance on a condition, may, for the purpose of showing that the transfer is a mortgage, be proved except against a subsequent purchaser or encumbrancer for value and without notice, notwithstanding that the fact does not appear by the terms of the instrument."

This section specifically says, "Every transfer . . . *other than in trust* . . . is a mortgage." This section states the Deed to a Trustee is not a mortgage and *cannot* be foreclosed as one.

A recent Arizona case, *Bank of Arizona v. Harrington, et al.*, 74 Ariz. 297, 248, P.2d 859 (1952), reviews the law on recording and creation of security interests and liens. The Court holds, at page 862, that "A prior unrecorded conveyance or mortgage creates no right as against creditors who have obtained liens." In this case the Deed is not a security instrument. The other instruments were not recorded. The recording of the United States Tax Lien places the United States and the Trustee ahead of the Title Company.

The United States Congress in enacting Sec. 6323 of the Revenue Act intended to give effect to the recording statutes of the several states. The courts must, therefore, give effect to the state recording requirements. *Reiter v. Kille,* 143 F. Supp. 590 (D.C., Pa. 1956).

The effect of the Arizona law would be to place the Bankruptcy Trustee and the United States Tax Lien ahead of the creditor-Appellant.

The priority of lien is governed by the common law rule, "The first in point of time is the first in right." *United States v. City of New Britain,* 347 U.S. 81, 85, 74 S.Ct. 367, 370, 98 L.Ed. 520 (1954).

In conclusion, it would appear the Title Company had "no prior recorded lien" and the circumstances were such that the unrecorded collateral assignment, Exhibit 1C, was not such an instrument that would come under the "*Windsor Square*" case and that the Trust Agreement, Exhibit 1B, was itself not a security device.

"COMMENTS ON

BARRINGER V. LILY

IN RE WINDSOR SQUARE DEVELOPMENT, INC."

Barringer v. Lily, in re Windsor Square Development, Inc., 96 F.2d 607, 9th CAA is cited by Title Company as being "almost identical" with the instant case and therefore controlling. The differences are set forth in what this writer thinks is in order of importance as quoted from the decision of the Court.

(a) "The *Trust instrument* declared that the indebtedness secured thereby (the $85,000 note) was a first lien upon and was secured by the entire beneficial interest thereunder, page 608.

(b) "A *warranty deed* to the property was executed by Mrs. Barringer in favor of Phoenix Title & Trust Company," page 608.

(c) "The fact that Tunney gave a note for $85,000 *and that the declaration of trust recited that it was to secure payment* of the note seem to lead irresistibly to the conclusion that the declaration of Trust was regarded as a mortgage," page 612.

(d) "If inquiry was made by the creditors they would have actual notice of the declaration of trust," page 613.

(e) "Record title was in the title and trust company." This, of course, is not the case in this appeal and the record title was in Phoenix Title & Trust Company, as Trustee, and for no other purposes. The Deed, which the Court construed as a mortgage, was a Deed to a creditor, and not to a Trustee.

The "*Windsor Square Case*" stands for the rule that persons such as those in that case *who have actual notice* are bound by a *declaration of trust* as though all formalities had been complied with, but "As to other persons, without notice thereof, it was as much a nullity as if it had never existed". (96 F.2d at 613·) The Bankruptcy Trustee is such a person without notice.

Although the above should dispose of and completely differentiate the *Windsor Square Case* from the instant case, the writer cannot fail to point out that a reading of the case shows the parties in that case were operating under ". . . circumstances to arouse suspicion," 96 F.2d at 613, and were self dealing.

STATUTE OF USES

In the Findings of Fact and Conclusions of Law dated the 31st of May, 1962, the Referee in Bankruptcy

found, *inter alia,* that Phoenix Title & Trust Company, as Trustee, was granted no discretionary powers and had no responsibility in handling and managing the subject property of the Trust; that the Trustee could act only at the direction of the beneficiaries; that the Deed to the Trustee and the Trust Agreement (Exhibits 1 and 1B, respectively), were executed by the parties with the intention of establishing a passive depository of the legal title to the real property with the actual and equitable ownership remaining in the Peabodys for their own use and benefit; and that Phoenix Title & Trust Company did not take title to the property as security for the performance of any contract or obligation to be performed on the part of the Peabodys. (See Findings of Fact No. II and No. IV, *supra.*)

The District Court, in its Order on Review dated the 29th of March, 1963, upheld the Findings of the Referee and determined that *ipso facto* the Trust was passive and executed by the Statute of Uses. This Court is bound by the decision of the lower court and should not set it aside unless clearly erroneous. *Tepper v. Chichester,* 285 F.2d 309 (9th Cir. 1960).

It is contended by the Appellant that under Sec. 131 of the Restatement of Trusts, admittedly the law in Arizona, the interest of the beneficiaries was personal property and therefore not subject to the operation of the Statute of Uses. This section provides:

> "Restatement of Trusts, Sec. 131 Equitable Conversion.
>
> "(1) If real property is held in trust and by the terms of the trust a duty is imposed upon the trustee to sell it and hold the proceeds in trust or distribute the proceeds, the interest of the beneficiary is personal property."

A further reading of the Restatement will reveal Comment C to this section which provides:

> "*No duty to convert.* The rules stated in this section are not applicable if the trustee has not a duty to convert but merely has a power which he may exercise in his discretion."

In the instant case the Appellant-Trustee did not even have a discretionary power to convert the realty, but could only act upon such terms and conditions as instructed by the beneficiaries in writing. To effect an equitable conversion in a Trust Agreement of realty, the duty must be unconditional and capable of being exercised at any and all times. *Gallagher v. Drovers Trust & Savings Bank,* 404 Ill. 410, 88 N.E.2d 870 (1949); see *In Re Good's Will,* 304 N.Y. 110, 106 N.E.2d 36 (1952); *Rubin v. Bartel,* 371 Ill. 117, 20 N.E.2d 80 (1939); *In re Hencke's Estate,* 212 Minn. 407, 4 N.W.2d 353 (1942). There is a distinction between a duty to sell and a mere authorization to sell on the part of the Trustee, and if the latter, the doctrine of equitable conversion has no application. See *Bitzer v. Moock's Executor and Trustee,* 271 S.W.2d 877 (Ky. 1954). There being no duty to convert on the part of the Trustee, it is manifest that the interest of the beneficiaries remained personalty.

This is true notwithstanding Paragraph X of the Trust Agreement (Exhibit 1B), which provides that

> "The interest of the Beneficiaries in this Trust is personal property, and the Beneficiaries have not and shall not at any time have any right, title or interest in or to the property covered hereby. . . ."

In *Smith v. Bank of American National Trust & Savings Association,* 14 Cal. App. 2d 78, 57 P.2d 1363 (1936), the Court, in dealing with a situation similar to this, held that words in a trust agreement providing that the

beneficiaries' interests should be personalty, and that no beneficiary should have any right, title or interest in and to the property covered thereby, did not create conversion of realty to personalty.

The Appellant further contends, in the alternative, that if the interest remaining in the beneficiaries is real property, the Statute of Uses does not operate thereon because the Trust imposes affirmative duties on the part of the Trustee. This contention is without merit for the power of control, disposition and sole use lies in the beneficiaries, the Appellant being a mere passive depository for the bare legal title. See generally 90 C.J.S. Trusts, Sec. 178.

A trust should not be required merely to accomplish a passing of ownership. 1A Bogert, Trusts and Trustees, Sec. 206. Under the terms of the Trust Agreement (Exhibit 1B) the beneficiaries were to pay all claims, demands, liens, taxes and assessments. The duties of the Trustee served no purpose that could not equally be served without the Trust. Such Trust is held to be simple, passive or dry. 90 C.J.S., Trusts, Sec. 178; see *Elvins v. Seesledt,* 141 Fla. 266, 193 So. 54, 126 A.L.R. 1001 (1940).

Appellant relies heavily on the language in *Chicago Title & Trust Co. v. Mercantile Trust & Savings Bank,* 300 Ill. App. 329, 20 N.E.2d 992. This case is readily distinguished from the instant proceedings in that the Illinois Court found the subject trust agreement sufficient to transfer the beneficial interest under the doctrine of equitable conversion. Upon the foregoing authority, such a conclusion cannot be reached based on the terms of the said Exhibit 1B. Furthermore, the court found the Trustee had a ". . . positive active duty . . . to sell any property remaining in the trust at the end of its prescribed

term. . . .", Id., 20 N.E.2d at 996. Paragraph XIV of the Trust Agreement herein permits the Trustee to convey to the beneficiaries any property not yet conveyed at the termination of the Trust. This does not constitute an active duty within the contemplation of the *Chicago Title* case.

The foregoing notwithstanding, if the interest of the beneficiaries is deemed personal property or that the Trust is active, it would appear as held by the District Court that the Collateral Assignment constitutes an unfiled chattel mortgage, void as to subsequent creditors of the Peabodys. A.R.S. Sec. 33-751(2), Sec. 1-215(22), and Sec. 33-753(1).

THE SCOPE OF REVIEW

The Referee's Findings of Fact and Conclusions of Law (T.R. 123) dealt with mixed questions of law and fact, and he made certain determination on those issues which were affirmed by the United States District Court (T.R. 171).

The Ninth Circuit Court of Appeals in *Tepper v. Chichester*, 285 F.2d 309 (1960), has held at page 312,

> "On review by this Court, we are required to accept the referee's findings unless they are clearly erroneous. Phillips v. Baker, 5 Cir., 1948, 165 F.2d 578; Porterfield v. Gerstel, 5 Cir., 1957, 249 F.2d 634; In re Gerber, 9 Cir., 186 F. 693. In reclamation proceedings, the findings of the referee on questions of intent, purpose, possession and the nature of the dealings between the parties are questions of fact, or in some instances, mixed questions of law and of fact, and the findings of the referee as approved and confirmed by the District Judge will not be set aside on anything less than a demonstration of clear mistake in applying the law. Kowalsky v. American Employers Insurance Co., 6 Cir., 1937, 90 F.2d 476; First National Bank of Portland v.

Dudley, 9 Cir., 1956, 231 F.2d 396; 4 Collier on Bankruptcy, 14th Ed., par. 70.39."

There certainly is in this case a dispute as to facts and it is respectfully submitted that as to those facts the findings of the Referee on questions of intent, purpose, possession, and nature of dealings should be affirmed, and that the District Judge be affirmed.

CONCLUSION

The argument as presented and the law relating to the facts of this action seem clear to the Appellee Trustee in Bankruptcy.

It is respectfully submitted that the entire argument of the creditor is based upon an attempt to distort the facts and the laws of the State of Arizona, and that a clear, simple reading of the Bankruptcy Act and the laws of the State of Arizona should result in the judgment of the Referee in Bankruptcy in the United States District Court being affirmed.

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APPENDIX

United States Bankruptcy Act:

Section 70(c).

The Trustee may have the benefit of all defenses available to the bankrupt as against third persons, including statutes of limitation, statutes of frauds, usury, and other personal defenses; and a waiver of any such defense by the bankrupt after bankruptcy shall not bind the trustee. The trustee, as to all property, whether or not coming into possession or control of the court, upon which a creditor of the bankrupt could have obtained a lien by legal or equitable proceedings at the date of bankruptcy, shall be deemed vested as of such date with all the rights, remedies, and powers of a creditor then holding a lien thereon by such proceedings, whether or not such a creditor actually exists.

Section 70(e).

(1) A transfer made or suffered or obligation incurred by a debtor adjudged a bankrupt under this Act which, under any Federal or State law applicable thereto, is fradulent as against or voidable for any other reason by any creditor of the debtor, having a claim provable under this Act, shall be null and void as against the trustee of such debtor.

(2) All property of the debtor affected by any such transfer shall be and remain a part of his assets and estate, discharged and released from such transfer and shall pass to, and every such transfer or obligation shall be avoided by, the trustee for the benefit of the estate: *Provided, however,* That the court may on due notice order such transfer or obligation to be preserved for the benefit of the estate and in such event the trustee shall succeed to and may enforce the rights of such transferee or obligee. The trustee shall reclaim and recover such property or collect its

value from and avoid such transfer or obligation against whoever may hold or have received it, except a person as to whom the transfer or obligation specified in paragraph (1) of this subdivision e is valid under applicable Federal or State laws.

Internal Revenue Code of 1954:

Section 6323. Validity Against Mortgagees, Pledgees, Purchasers, and Judgment Creditors.

(a) Invalidity of Lien Without Notice. Except as otherwise provided in subsection (c), the lien imposed by section 6321 shall not be valid as against any mortgagee, pledgee, purchaser, or judgment creditor until notice thereof has been filed by the Secretary or his delegate.

(1) Under State or Territorial Laws. In the office designated by the law of the State or Territory in which the property subject to the lien is situated, whenever the State or Territory has by law designated an office within the State or Territory for the filing of such notice; or

(2) With Clerk of District Court. In the office of the clerk of the United States district court for the judicial district in which the property subject to the lien is situated, whenever the State or Territory has not by law designated an office within the State or Territory for the filing of such notice; or

(3) With Clerk of District Court for District of Columbia. In the office of the clerk of the United States District Court for the District of Columbia, if the property subject to the lien is situated in the District of Columbia.

(b) Form of Notice. If the notice filed pursuant to subsection (a) (1) is in such form as would be valid if filed with the clerk of the United States

district court pursuant to subsection (a) (2), such notice shall be valid notwithstanding any law of the State or Territory regarding the form or content of a notice of lien.

(c) Exception in Case of Securities.

(1) Exception. Even though notice of a lien provided in section 6321 has been filed in the manner prescribed in subsection (a) of this section, the lien shall not be valid with respect to a security, as defined in paragraph (2) of this subsection, as against any mortgagee, pledgee, or purchaser of such security, for an adequate and full consideration in money or money's worth, if at the time of such mortgage, pledge, or purchase such mortgagee, pledgee, or purchaser is without notice or knowledge of the existence of such lien.

(2) Definition of Security. As used in this subsection, the term "security" means any bond, debenture, note, or certificate or other evidence of indebtedness, issued by any corporation (including one issued by a government or political subdivision thereof), with interest coupons or in registered form, share of stock, voting trust certificate, or any certificate of interest or participation in, certificate of deposit or receipt for, temporary or interim certificate for, or warrant or right to subscribe to or purchase, any of the foregoing; negotiable instrument; or money.

(d) Disclosure of Amount of Outstanding Lien. If a notice of lien has been filed under subsection (a), the Secretary or his delegate is authorized to provide by rules or regulations the extent to which, and the conditions under which, information as to the amount of the outstanding obligation secured by the lien may be disclosed.

26 U. S. Code:

Section 6321. Lien for taxes.

If any person liable to pay any tax neglects or refuses to pay the same after demand, the amount (including any interest, additional amount, addition to tax, or assessable penalty, together with any costs that may accrue in addition thereto) shall be a lien in favor of the United States upon all property and rights to property, whether real or personal, belonging to such person.

Section 6322 (formerly Section 3671).
Period of lien.

Unless another date is specifically fixed by law, the lien imposed by section 6321 shall arise at the time the assessment is made and shall continue until the liability for the amount so assessed is satisfied or becomes unenforceable by reason of lapse of time.

Arizona Revised Statutes:

Section 1-215, subdivision 22. Definitions.

22. "Personal property" includes money, goods, chattels, dogs, things in action and evidences of debt.

Section 33-751. Types of personal property which may be mortgaged.

Mortgages may be made upon:

1. All growing crops.

2. All kinds of personal property except on a stock of goods, wares or merchandise daily exposed to sale as set forth in the provisions of § 33-752. As Amended Laws 1956, Ch. 159, § 1.

Section 33-753. Requirements of validity of mortgage.

A mortgage of personal property or crops is void as against creditors of the mortgagor and subsequent purchasers and encumbrances of the property in good faith and for value, unless:

1. The mortgage is acknowledged in like manner as instruments of conveyance of real property.

I certify that, in connection with the preparation of this brief, I have examined Rules 18 and 19 of the United States Court of Appeals for the Ninth Circuit, and that, in my opinion, the foregoing brief is in full compliance with those rules.

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